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SENATE



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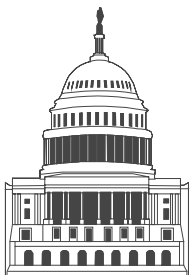
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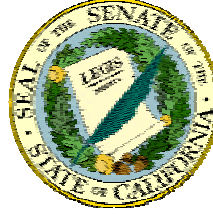
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JUNE 15, 2000

# SENATOR BILL MORROW



## CAPITOL UPDATE

### *Hang Onto Your Wallets: It's Budget Time!*

Every year at this time the Governor and Legislature step out together and perform the Budget Dance. The Governor leads. The Legislature follows. The special interests hold their instruments and play the tune. The bureaucrats line up on either side of the dance floor and clap their hands in rhythm. . . . And the taxpayers get their feet stepped on again and again and again.

Passing the State Budget Bill is the most important routine business done annually in the State Capitol. The programs it funds or cuts affect the lives of millions of people, especially children. The money taken in to fund the Budget comes directly out of your pocket. You pay for these programs. Responsible citizens need to know how the budget process works.

### UNDERSTANDING THE BUDGET PROCESS

A new budget is adopted each fiscal year, which runs from July 1st to June 30th. The budget has an annual trek through both houses, committees, subcommittees before it is agreed upon and signed by the governor.

Below is a timeline to help you better understand how California's multi-billion-dollar budget is created.

**July 9<sup>th</sup> – Sept. 15:** State department directors and agency heads send their development requests to the Department of Finance (DOF) for review.

**Oct.-Jan. 10:** The governor evaluates the requests as reviewed by the DOF and sends his/her request to the Legislature.

**Jan.-Feb.:** The budget proposal is introduced in both the Assembly and the Senate as identical budget bills.

**March-April:** The budget bills are sent from each house to their respective budget committees where they are then broken down by subject and assigned to a subcommittee.

**Late April-June 15<sup>th</sup>:** After completion of hearings in both subcommittees and standing budget committees, a revised budget bill is sent to the floor of each respective house for evaluation and vote. The differences between the Assembly and the Senate version are worked out in a conference committee, which then sends a combined, single version back to both houses. The Senate and Assembly each vote on this final version and then send it to the Governor.

**July 1:** The governor has until July 1<sup>st</sup> to sign or veto the budget, which becomes law immediately.

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### BRIEF RECAP OF SB 75 The Senate Budget Bill

The Senate Budget Bill for 2001-02 -- SB 75 (Peace) -- increases General Fund expenditures by \$385 million over the Governor's Budget as revised by the May Revision. In addition, SB 75 includes reversions and transfers totaling \$1.4 billion more than the May Revision. The net affect

of these spending increases and funding shifts is to increase the Reserve for Economic Uncertainty to \$2.4 billion.

**Reserve**—In California, there has been a longstanding agreement that a prudent reserve would be at least 3 percent of General Fund revenues. Senate and Assembly Republicans have consistently advocated for such a reserve and made room for one in their "Joint Caucus Budget Priorities" announced last December. The Governor's Budget proposal fell short of this goal which included a reserve of \$1.9 billion, or 2.4 percent of then-estimated revenues. The May Revision reduced the reserve to \$1 billion, a mere 1.3 percent of revenues. The \$2.4 billion reserve provided by SB 75 represents 3.3 percent of General Fund revenues.

**Optimistic Assumptions on Energy and Cash-flow**—The May Revision assumes and SB 75 appears to endorse the assumption that the recently authorized \$13.4 billion in revenue bonds will be adequate to pay back General Fund loans and continue purchasing power as long as it is needed. In reality, even a best-case scenario shows that the state will run out of cash no later than March of 2002, well short of the Davis administration's very optimistic target date of November 2002 for "breaking even" on the power purchase program. While the increased reserve provided by SB 75 will help with this cash-flow problem, it is probably still not adequate if the state's energy purchases exceed the Administration's expectations.

**Operating Deficit**—The Senate budget is actually a deficit budget in that it proposes General Fund expenditures of \$80.1 billion, with revenues of only \$74.8 billion, an operating deficit of \$5.3 billion.

**SB 75, like the May Revision, Pushes Spending Pressures Into the Out-year**—We asked the Legislative Analyst's Office to project the May Revision budget into 2002-03. The projection assumes no additional law changes or policy changes beyond those included in the May Revision. This baseline projection shows that General Fund costs will rise to \$84.5 billion in 2002-03 which is almost \$10 billion more than the DOF revenue estimate for 2001-02. In other

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words, Governor Davis's May Revision relies on state revenues to grow by \$10 billion, or 13 percent, just to break even in 2002-03. SB 75 essentially endorses this approach, with only a small part of the additional reserve coming from permanent, ongoing spending cuts.

*For the full report or for more information on this subject contact the Senate Republican Fiscal Office at 916-323-9221.*

### UPDATE: Where are we now?

By June 11 of 2000, the Budget Conference Committee had met 11 times and had virtually completed negotiations on the Budget Bill of 2000. By June 11 of 2001, the Budget Conference Committee had met 4 times and was nowhere near closure on any significant issue.

Relative to the Senate Version of SB 75, the Conference Committee has (1) increased current-year General Fund spending by \$192 million, (2) reduced budget-year General Fund revenues and transfers by \$655 million, and (3) reduced budget-year General Fund expenditures by \$113 million. These actions have reduced the Reserve for Economic Uncertainties from \$2.4 billion (3.2 percent) to \$1.7 billion (2.3 percent).

The major issue that seems to be holding up agreement on specific budget items is the overall question of how large the Reserve should be. Given the LAO's advice that the May Revision proposal would result in a deficit in the out-year (2002-03) of at least \$4 billion, Senate Democrats have expressed an interest in building a larger reserve. The DOF has indicated that it is raising its targeted reserve from the \$1 billion proposed in May to approximately \$2 billion, although the administration has not advised the Conference Committee which proposals should be cut to achieve this. Assembly Democrats have indicated a willingness to leave a reserve of about \$1.6 billion and a desire to use any available funds to cover a variety of Assembly Bills. Republicans have consistently supported a larger reserve.

The Conference Committee has left open (deferred action on) most of the major issues and continues to meet. They are currently about half way through.

*For a longer summary of a significant issues by subject contact the Senate Republican Fiscal office.*

### Comparison of Senate and Assembly Versions of the Budget General Fund 2001-02

**Prior-Year Fund Balance**—The Senate version shows a slightly higher prior-year fund balance. The small net difference reflects several offsetting factors. For example, the Senate version includes the effects of current-year spending reversions and prior-year reductions to Proposition 98 funding, while the Assembly version reflects the LAO's higher current-year revenue estimates.

(In Millions)

	Senate Version	Assem. Version	Difference
Prior-year fund balance	\$7,222	\$7,205	-\$17
Revenues and transfers	\$75,777	\$76,079	-302
Total resources			
Available	\$83,301	\$82,982	-\$320
Expenditures	\$80,061	\$80,399	\$338
Ending fund balance	\$3240	\$2,583	-\$658
Encumbrances	\$701	\$701	—
Set-aside for legal			
Contingencies	\$100	\$100	—
<b>Reserve</b>	<b>\$2,439</b>	<b>\$1,781</b>	<b>-\$658</b>

**Revenues and Transfers**—The Senate version includes 2001-02 revenues and transfers that are \$302 million higher than the Assembly version. This net budget-year difference primarily reflects the Senate's transfer of about \$750 million in special fund balances to the General Fund, partially offset by the Assembly's adoption of LAO's higher revenues.

**Expenditures**—The Assembly budget includes \$338 million more in expenditures than the Senate, largely relating to health, social services, and education. The net

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difference also includes a wide variety of other factors. For example, the Senate includes \$300 million savings from vacancies, but also incorporates \$260 million in added funding for extension of the current-year increase in the senior citizens' tax credit.

**Operating Balance**—In both the Assembly and Senate versions—as well as in the May Revision—expenditures exceed revenues by roughly \$4 billion, resulting in a drawing down of the reserve. This imbalance has significant implications for 2002-03 (see full report for further details).

**Reserve**—Both houses include reserves which are significantly larger than the May Revision proposal. The Senate's reserve is about \$650 million higher than the Assembly. In addition, both versions include a \$100 million set-aside for legal contingencies.

## Key Features of the Senate and Assembly Budgets

### Revenues and Transfers

- The Assembly version is based on the LAO's revenue forecast, which is \$276 million higher in the current year and \$373 million higher in the budget year.
- The Senate version includes about \$750 million related to transfers of balances from special funds.
- Neither version reflects the federal tax reduction measure that was recently agreed to in Congress, which would result in the phase out of California's estate tax. The measure would reduce California revenues by over \$100 million in 2001-02, over \$400 million in 2002-03, over \$750 million in 2003-04, and over \$1.1 billion in 2004-05.

### Tax Relief

- Both houses adopted the Governor's proposed increase in the Manufacturers' Investment Tax Credit and extension of the capital gains exclusion for small business stock gains. Also, the Senate version makes permanent the current-

year's increases in the senior citizens' tax credit.

### Education

- The Senate and Assembly fund K-14 Proposition 98 at a similar aggregate level. The houses, however, differed significantly in many program allocations. For example, the Senate added general purpose money for school districts by altering the "Public Employees' Retirement System reduction" amount while the Assembly provided equalization funding.
- With regard to the Governor's proposal on longer school year for middle grades, the Senate set aside \$65 million pending enactment of legislation whereas the Assembly rejected the proposal.
- There were numerous differences between the houses on one-time Proposition 98 spending. Key differences involve (1) the amounts appropriated for prior-year "settle-up" obligations and (2) the allocation of these one-time monies among programs—particularly energy-related spending.

### Transportation

- Both houses essentially adopted the May Revision proposal related to Transportation Congestion Relief funding, including \$1.3 billion in the budget year and \$1.2 billion in 2002-03. Due to slight differences, however, this is a conference item.

### Health and Social Services

- The Assembly version includes \$213 million in higher funding in the health budget for various program expansions including trauma care and mental health.
- Both houses (1) eliminated sunsets for cash and food benefits for recent immigrants, (2) rejected the Governor's reduction of Child Welfare Services, (3) fully funded Stage 3 child care, and (4) rejected the Governor's proposal to establish a Tobacco Settlement Fund. The Assembly also added funding for

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various new foster care and child welfare initiatives.

### Other

- The Senate version includes expenditure savings from reversions (\$200 million) and elimination of vacancies (\$300 million), as well as added revenues from one-time transfers of balances in special funds (\$750 million).

For the full report visit the LAO's website @

<http://www.lao.ca.gov/>

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